Global Legal Insights

Mergers & Acquisitions

2017

Sixth Edition

Editors:
Michael E. Hatchard & Scott V. Simpson

global legal group

CONTENTS

Cayman Islands

Ramesh Maharaj, Rob Jackson & Melissa Lim
Walkers

Overview

The Cayman Islands' global appeal means it services clients from all corners of the globe, thereby offering a hedge against the full brunt of economic fluctuations which ordinarily affect a single jurisdiction. Whilst M&A activity has decreased throughout 2016 on a worldwide basis by 22%,[1] Cayman Islands M&A activity remained steady.

During 2015 and the first six months of 2016, 15,842[2] exempted companies and 4,971[3] exempted limited partnerships were incorporated or formed (as relevant). The continued use and attraction of Cayman Islands entities is not surprising, as the nature of capital has changed dramatically in the last few years, with investments increasingly being made on an international scale. Investors are at ease moving their capital from one jurisdiction to another to achieve the highest returns. The more international capital becomes, the more likely Cayman Islands entities are used to facilitate the investment of such capital due to the tax neutrality afforded, and the sophisticated and stable nature of the jurisdiction.

The Cayman Islands has historically been, and continues to be, successful in attracting funds (both hedge funds and private equity funds) as well as structured finance issuers. Over time, the Cayman Islands has become recognised as a jurisdiction that is central to M&A transactions, particularly cross-border M&A transactions in downstream private equity transactions.

As noted above, with global M&A decreasing in 2016 as compared to 2015, the need for strategic global structuring solutions has increased. Given that Cayman Islands exempted limited partnerships are the vehicle of choice for offshore private equity funds, the private equity sector has embraced the use of Cayman Islands vehicles as holding companies, joint venture vehicles and listing vehicles for M&A deals. In light of the increase in private equity-backed M&A, the Cayman Islands has benefited from a number of deals involving Cayman Islands vehicles. Furthermore, the recent introduction in July 2016 of a Cayman Islands Limited Liability Company, or "LLC", should further supplement the attractiveness of the jurisdiction for clients familiar with the benefits of such vehicles in onshore jurisdictions such as Delaware.

Despite the volatility and uncertainty in the global equity markets, a key factor in the increase in private equity-backed M&A deals is the relative resiliency of the debt markets. According to Thomson Reuters, global syndicated lending for the first nine months 2016 reached US$2.9trn.[4] Loans in the Americas accounted for 57% of global loan volume during the first nine months 2016. With greater access to loans particularly in the US, private equity funds have the capital available to complete their buyout transactions, thereby increasing the number of private equity-backed M&A deals. Not only is the Cayman Islands a jurisdiction favoured by private equity houses, it is a jurisdiction that is recognised to be creditor-friendly and therefore favoured by leverage providers. Accordingly, the use of Cayman Islands vehicles is expected to increase, with such buoyant private equity-backed M&A activity and the associated leveraged loans to fund such activity.

Reasons why the Cayman Islands are a preferred jurisdiction to facilitate M&A activity

The Cayman Islands is the destination of choice for the offshore structures which run parallel to onshore private equity structures. This is in large part due to the fact that it delivers the ability to raise capital efficiently, in a tax-neutral environment. It is common for a Cayman Islands entity to be used in international M&A transactions, whether it is to act as a holding vehicle for a bidco in an acquisition context, to act as a joint venture vehicle, or to act as the issuer to be listed on stock exchanges. The reasons for doing so are varied and can include any of the following:

- *Simplicity and speed of incorporation* – incorporation can usually be completed within 24 hours (using an express service) following completion of relevant know-your-client ("KYC") and anti-money-laundering ("AML") requirements.
- *Major international financial and banking centre* – the Cayman Islands is a major international financial and banking centre and has many leading international banks, trust companies, accounting firms, law firms and other such service providers.
- *Well established legal system and flexible corporate governance* – the Cayman Islands are administered as a British Overseas Territory, but have a significant degree of internal self-government. The Cayman Islands have a combined common law and statute-based legal system. English common law is of persuasive authority and the courts of the Cayman Islands are of good repute. Corporate governance is based on such common law and statute-based legal systems, with the flexibility to take into account the different needs of the parties, whether it is for a listing vehicle, bidco or joint venture vehicle.
- *No direct or indirect taxation* – exempted companies and LLCs are free from any form of income tax, capital gains tax or corporation tax, and no withholding tax is imposed by the Cayman Islands on any cash flows. Exempted companies are eligible to apply for an undertaking from the Cayman government to the effect that they will remain tax-free for a period of 20 years (which can be extended to 30 years for exempted companies, or to 50 years for LLCs, where the term of the transaction requires this) in the event of any legislative changes relating to taxation matters.
- *No exchange controls* – the Cayman Islands has no exchange control or currency regulations.
- *Corporate documents not publicly available* – the constitutional documents, the identity of the shareholders and directors of an exempted company are not available to the public and, additionally, the identities of the shareholders are not known by any governmental authority in the Cayman Islands (except in the case of certain regulated entities).
- *Compliance* – there are stringent compliance and KYC procedures in place to target money laundering.
- *Ability to merge or consolidate with a non-Cayman Islands company* – the Cayman Islands Companies Law permits an exempted company or LLC to merge or consolidate with Cayman Islands and/or overseas companies. See below for greater detail on the statutory merger regime.

- *Reporting* − annual reporting requirements are minimal and consist only of a statement, signed by the company secretary or a director, that the company has conducted its operations mainly outside the Cayman Islands and has complied with the provisions of the Companies Law.
- *Directors* − there are no requirements that directors of an exempted company or managers of an LLC be resident in the Cayman Islands.
- *Regulatory regime* – the Cayman Islands has a flexible regulatory regime in order to stay at the forefront of offshore financial centres and to encourage further investment through the Cayman Islands. An example of this is the introduction of the new Cayman Islands LLC (see below).
- *Time zone and geographical proximity* – the Cayman Islands is favoured as an offshore jurisdiction by the US, given its location in the same time zone and its geographical proximity.

Deals and highlights

<u>Take-private transactions</u>

"Take-private" deals are being driven by private equity and/or management of listed companies in the belief that they can increase the value of the company once it is de-listed and no longer subject to the increased reporting and regulatory costs associated with a listing.

In some cases, management has teamed up with private equity houses to effect the buyout of the relevant company, which raises issues of director duties and conflicts of interest. In such cases, where the target is a Cayman Islands company, Walkers has been involved in advising on such matters, whether it is from the perspective of the acquirer, the target, or the special committee of non-conflicted directors that may be formed to consider the buyout proposal.

The duties that govern the actions of the directors of a target company are not codified in the Cayman Islands, and so are set out in the common law as it has been developed, in the Commonwealth courts in particular. The abiding general principle is that the directors of a Cayman company owe their duties to the company and not to its shareholders. It is likely in a management buyout scenario that the Cayman courts will focus carefully on the following areas when considering the discharge by the company's directors of their fiduciary duties: (i) directors are not precluded by Cayman law from voting on, or prosecuting, a transaction in which they have a personal interest provided that the nature of that interest is disclosed, and any company information held by the directors in that capacity and which is material to the consideration and approval of the proposed transaction by shareholders is disclosed to them; and (ii) it will be important that any valuation of the company forming the basis of any offer to shareholders under the proposed transaction is supportable by reference to independent, informed third party advice.

The following are some high-profile take-private transactions involving Cayman Islands companies:

- Bohai Leasing and its take-private acquisition of NYSE-listed Avolon Holdings.
- Morgan Stanley and Credit Suisse in connection with the leveraged buyout of Goodpack Ltd by IBC Capital Ltd., the largest ever buyout of a Singapore-listed company by a private equity fund.
- Consortium led by Blackstone, in its US$625m privatisation of Pactera Technology International Limited.

- Acquity Group Limited, in connection with the US$316m take-private acquisition of NYSE-listed e-commerce and digital marketing company Acquity Group Limited by consulting firm Accenture PLC.
- China Fire & Security Group, Inc., in its US$265.5m take-private acquisition of NASDAQ-listed China Fire & Security Group, Inc. China Fire & Security Group, Inc. is a leading total solution provider of industrial fire protection systems in China.
- Giant Interactive, in connection with the takeover of NYSE-listed Chinese online game developer Giant Interactive, with a total value of approximately US$2.9bn.
- International Mining Machinery Holdings Limited, in connection with the going private acquisition by Joy Global Asia Limited, a wholly owned subsidiary of Joy Global Inc.

<u>Strategic corporate acquisitions</u>

Strategic corporate acquisitions are also on the rise, in light of the buoyant state of the global economy:

- Uber China and its 2016 merger with Didi Chuxing.
- Petroamerica Oil Corp. and the acquisition of all of its issued and outstanding shares by Gran Tierra Energy Inc.
- Funds managed by Blackstone in respect of the sale of Center Parcs, a UK-based holiday village company, to a fund managed by Brookfield Property Partners.
- Home Loan Servicing Solutions on its US$1.2bn acquisition by New Residential Investment.
- Valeant Pharmaceuticals International, Inc. and its acquisition of Mercury (Cayman) Holdings, the holding company of Amoun Pharmaceutical, for approximately US$800m.
- Atlantica Hotels International Ltd., the holding company for Atlantica Hotels International (Brasil) Ltd, the largest privately held hospitality company in South America, in its sale to Quantum Strategic Partners Ltd (an affiliate of Soros).
- The Carlyle Group and Warburg Pincus, a global private equity firm, and the acquisition of DBRS, the fourth-largest global credit rating agency.
- Tiger Media, Inc., a Shanghai-based multi-platform media company, in its acquisition of The Best One, Inc., parent company of US-based data solutions provider Interactive Data, LLC.
- Baring Private Equity Asia in connection with its acquisition of Vistra Group, a global provider of trust, fiduciary and fund administration services.
- Accenture/Acquity, in connection with the US$316m take-private acquisition of NYSE-listed e-commerce and digital marking company Acquity Group Limited by consulting firm Accenture PLC.
- Alibaba Group, in its US$586m acquisition of an 18% stake in China's largest internet portal and media website Sina Corp's microblogging service, Weibo.
- Baidu, in connection with its US$306m acquisition of Qunar, one of China's oldest and biggest online travel agents.
- Lombard International Assurance, and the acquisition of the Luxembourg-based wealth management business of Lombard International Assurance and Switzerland-based Insurance Development Holdings AG from Guernsey-based Friends Life Group Limited.
- Formation Capital, LLC, and the $763m acquisition of NHP Group, a property company which held 275 properties located throughout the UK.

M&A activity in the domestic market of the Cayman Islands

Cayman Islands entities are commonly used in offshore international M&A transactions, and the focus of the Cayman Islands tends to be on activities offshore rather than onshore in the Cayman Islands. However, within the domestic market of the Cayman Islands itself, M&A activity has been on the rise with the consolidation of the financial services industry, such industry being one of the main pillars of the economy of the Cayman Islands. Recent notable transactions include the acquisition by Mitsubishi UFJ Financial Group of UBS' Alternative Fund Services business in the Cayman Islands, and Intertrust's acquisition of Elian Group's fiduciary business.

Merger regime as a means of acquisition

One area of particular growth involving Cayman Islands companies has been the utilisation of the Cayman merger statute as a preferred method for acquisitions. In the M&A arena, it is the merger and consolidation provisions of the Cayman Islands Companies Law (based on the statutory merger regime of Delaware) which have been used as the acquisition method of choice in a plethora of transactions upon which Walkers has advised. It is surprising to note that, prior to 2009, the Cayman Islands did not have a statutory merger regime. When first introduced, it was perhaps not envisaged that it would be used as an alternative to a scheme of arrangement or tender offer as a means of effecting a takeover.

Limited Liability Company – a new Cayman Islands vehicle

In light of the popularity of the use of the Delaware limited liability company, the government of the Cayman Islands has introduced a new Cayman Islands vehicle similar to such entity, also called a Limited Liability Company (the "**LLC**"). The LLC Law is based on the Delaware LLC Law and became operational in mid-July 2016.

An LLC is similar to a Delaware LLC. It is a body corporate with separate legal personality and requires at least one member. The liability of a member to make contributions to the LLC are limited to such amount set out in the LLC Agreement (unless otherwise agreed by the member). Registration of the LLC may be effected by the payment of a fee and filing of a certificate of formation with the Registrar of Limited Liability Companies in the Cayman Islands (the "**Registrar**"). The LLC Agreement is not required to be filed with the Registrar.

There is a focus on giving the members the flexibility to agree the governance of the LLC. Members are free to agree the internal workings of the LLC amongst themselves via the LLC Agreement. This allows the members to agree mechanisms such as capital accounts and capital commitments, allocations of profits and losses, allocations of distributions, voting methods (including negative consents) and classes of interests. The management of the LLC shall vest in its members acting by a majority in number unless the LLC Agreement provides for the management of the LLC by one or more managers, in which case, the management of the LLC shall vest in the managers. The LLC Agreement may provide for classes of managers having such rights, powers and duties for the relevant class as specified therein.

The LLC addresses the needs of clients who wish to have a body corporate that has the characteristics of a partnership in terms of capital accounts and capital commitments. The LLC is seen as a hybrid between an exempted Cayman Islands company and a Cayman Islands exempted limited partnership. As a Cayman Islands exempted limited partnership does not have separate legal personality, an LLC fills such gap, as it has separate legal personality but also has the partnership concepts of capital accounts and capital commitments.

A Cayman Islands company has certain restrictions on return of capital and is required to maintain its capital, so distributions made by a Cayman company are not as flexible as those of a partnership. Accordingly, an LLC also fills such gap where a client may be looking for a corporate entity but want flexibility in its distributions. Since their introduction, LLCs have been formed mainly to act as general partners of Partnerships, holdings companies and joint venture vehicles.

Industry sector focus

Private equity

We have continued to act on numerous downstream private equity fund transactions from a variety of industry sectors. These deals are being closed where the opportunities arise on a case-by-case basis without any particular trend towards an industry sector (outside of energy and power, and the intellectual property and information technology sectors as described above).

Telecommunications, intellectual property and information technology

The boom in Silicon Valley has resulted in a very busy M&A world in telecommunications, IP and IT. Companies that specialise in software solutions, cloud-based services, information technology services and social media are becoming attractive targets as they start establishing their revenue streams. Private equity houses are on the lookout for value opportunities, whilst management are focusing on extracting value from their companies.

Energy and power

Despite the declines in commodity prices in recent years, the energy and power sector remains active. Certain companies look to acquire undervalued assets and establish cost efficiencies through consolidation during volatile times, while other producers in need of cash to service debt may seek to divest of certain non-core assets. Although valuations may have decreased for many energy companies, their assets can still be objectively valued, in a world where valuation concerns and jitters abound.

Due to its capital-intensive nature, many companies have looked to refinance existing debt obligations. Technology providers who service the energy and power sector have found themselves an object of desire as the search for cost-effective production techniques and downstream efficiencies continues.

Real estate

Generally, real estate M&A transactions require the use of onshore vehicles, therefore Cayman Islands vehicles are not generally used as holding companies for real estate. Having said this, given that many real estate funds are Cayman Islands exempted limited partnerships, it is common for a Cayman Islands partnership to grant guarantees or sponsor support in M&A transactions in which its real estate holding subsidiaries are involved.

Infrastructure and projects

We have been involved in a number of large infrastructure projects; however it is difficult to discern any upward trend. These projects have a long shelf life, and many have not yet progressed to finalisation.

The year ahead

It's currently difficult to predict the trends for 2017 for the North America market, although we expect there may be a short lull in the intensity of M&A activity as the macro-economic policies of the new U.S. administration become clearer. Whatever direction is taken, we anticipate a need for Cayman Islands entities to structure investments either in or from the United States. The Asian markets are predicted to remain strong and we expect the growth of Cayman Islands entities in that region to continue.

We expect that global volatility in the equity and debt markets, as well as the low oil price environment, will result in a continued appetite for private market opportunities and deal flow globally.

* * *

Endnotes

1. As reported in *Mergers & Acquisitions Review*, Financial Advisors, First Nine Months 2016, Thomson Reuters.
2. Cayman Islands Register of Companies.
3. Cayman Islands Register of Partnerships.
4. As reported in *Global Syndicated Loans Review*, Managing Underwriters, First Nine Months 2015, Page 1, Thomson Reuters.

Ramesh Maharaj
Tel: +1 345 914 4222 / Email: ramesh.maharaj@walkersglobal.com
Ramesh Maharaj is based in Walkers' Cayman Islands office where he is a partner in the Global Finance and Corporate Groups. Ramesh specialises in corporate and finance transactions involving Cayman Islands entities. He regularly advises on take-overs, mergers, acquisitions, joint ventures, shareholders arrangements, injection of capital (by contribution or otherwise), return of funds to shareholders, IPOs, group reorganisations, corporate restructurings and corporate note/bond offerings. He advises a broad cross-section of clients including those in the resources and energy industry sectors, as well as Canadian-based or related transactions and advises private equity houses on a multitude of corporate down-stream transactions. Ramesh is active in advising clients (both banks and borrowers) on lending and security transactions with a Cayman Islands element.

Rob Jackson
Tel: +1 345 914 4281 / Email: rob.jackson@walkersglobal.com
Rob Jackson is a partner in Walkers' Global Finance and Corporate Groups, and advises on a broad range of finance and corporate transactions involving Cayman Islands companies and partnerships. In the finance arena he acts for lenders, borrowers and sponsors on project finance transactions, hedge fund and private equity financings, secured cross-border transactions and financial restructurings. Rob's finance clients include leading international banks and financial institutions, asset management firms and private equity houses as well as leading onshore law firms. In relation to corporate transactions, Rob regularly advises major public and private companies on share acquisitions and disposals, joint venture and shareholder arrangements, IPOs and secondary public offerings, corporate note/bond issues and corporate restructurings including statutory mergers, schemes of arrangement and takeovers, across a wide range of industry sectors. He has extensive experience in advising on the formation and structuring of Cayman Islands private equity vehicles and related downstream transactions.

Melissa Lim
Tel: +1 345 814 4512 / Email: melissa.lim@walkersglobal.com
Melissa Lim is based in Walkers' Cayman Islands office where she is a partner in the Global Investment Funds Group. She has extensive experience in a broad range of investment fund structures including private equity funds, hedge funds and unit trusts. Melissa regularly acts for leading investment banks, investment managers, private equity houses and corporate trustees, advising on the structuring and formation of funds, their downstream transactions and exit mechanisms. An integral part of her practice involves advising in relation to mergers and acquisitions, joint ventures, preference share issues, corporate restructurings and other corporate transactions. She also has significant expertise in advising on finance transactions (in particular, capital commitment subscription financing and LBO financing) and related issues of security creation and perfection.

Walkers

190 Elgin Avenue, George Town, Grand Cayman KY1-9001, Cayman Islands
Tel: + 345 949 0100 / Fax: + 345 814 8232 / URL: www.walkersglobal.com

www.globallegalinsights.com

Other titles in the **Global Legal Insights** series include:

- **Banking Regulation**
- **Bribery & Corruption**
- **Cartels**
- **Commercial Real Estate**
- **Corporate Tax**
- **Employment & Labour Law**
- **Energy**
- **Fund Finance**
- **Initial Public Offerings**
- **International Arbitration**
- **Litigation & Dispute Resolution**
- **Merger Control**

Strategic partner